

DECLARATION OF EMERGENCY

Department of Insurance
Office of the Commissioner

Year 2000 Exclusions
(LAC 37:XIII. Chapter 87)

In accordance with the provisions of R.S. 49:953B et seq. of the Administrative Procedure Act the Commissioner of Insurance has adopted emergency Regulation 69 in order that it might be implemented without delay in order to protect the public welfare. The Regulation addresses the impending Year 2000 crisis and its impact on the availability of insurance coverage in Louisiana.

By providing a mechanism for transferring risk insurance acts as an underpinning for modern day commerce and life in general. If insurance were to become unavailable, the effect upon Louisiana businesses and citizens would be severe and potentially devastating. The economic impact would be so disruptive it would put at risk the general welfare of the citizens of this state. Because the availability of insurance to Louisiana businesses and citizens is so vital it is necessary that this regulation be adopted on an emergency basis.

Further, since "Y2K" exclusions are already being introduced into the market, emergency rulemaking is necessary to establish parameters on the appropriate use of such exclusions. The failure to adopt this regulation on an emergency basis will delay and otherwise impair the ability of the LDOI to take action, should it become necessary, to protect the interest of the public and Louisiana policyholders.

This regulation will take effect in March, 1999, upon publication in the Louisiana Register. It shall remain in effect 120 days or until it is adopted as a permanent regulation through the normal promulgation process, whichever occurs first.

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TITLE 37
INSURANCE
Part XIII.

Chapter 87. Regulation 69 - Year 2000 Exclusions

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Preamble

It is a given that come January 1, 2000, and perhaps sooner for some systems, computers which have not been made Y2K compliant will read the wrong date. What is not a given is what results may follow from a computer's miscalculation of the year. It may be that very little will happen but, it is more likely that problems will arise, some of which may be severe in nature.

Most losses from Y2K will be economic losses arising from the cost of replacing or upgrading computer systems and embedded chips and the loss of income if there is a system failure which shuts down business operations. The average cost to upgrade software is \$1.00 to \$2.00 per line. Billions will be spent by private industry and government to make their systems Y2K compliant. The expense of becoming Y2K compliant will be compounded by the shortage of trained personnel, especially those who are trained in the older computer languages such as COBOL and FORTRAN.

As a general rule, insurance policies do not cover economic losses. That is, they do not respond to suits in contract, i.e. for breach of warranty and/or failure to perform or for the consequential damages arising from the breach of contract. However, faced with the possibility of a catastrophic event, the industry has developed exclusions to preclude, or at least minimize, the shifting of the economic costs posed by the Year 2000 problem to it. Most of the Y2K exclusions filed by the industry contain very broad language.

The rationale provided by insurers for approval of the Y2K exclusions includes the potential risk that the cost of repairing, upgrading or replacing non-Y2K compliant computer systems, including systems which employ embedded chips, will be shifted to the insurance industry by a policyholders and judges looking for "deep pockets". There is concern that lawsuits which involve first party disputes which are outside of the scope of coverage provided under liability policies might be recast as "liability" claims. Another area of concern is the possibility that "data and media" may be recategorized as "tangible property" to satisfy the predicate for "property damage" under property and liability policies. And there may be an increase in suits against software vendors and providers under expanded theories of negligence or professional "tradesperson" liability which may trigger coverage where previously none has existed.

Due in large part to the regulatory problems arising from the use of pollution exclusions in underwriting and claimshandling, the LDOI was not inclined to approve the Y2K exclusions. A sub-committee was formed to study the issue. Eventually the decision was made to approve Y2K exclusions, in order to avoid a disruption in the market, but the approval was conditioned upon industry compliance with Bulletin LIRC 98-04 and with this Regulation.

In adopting Regulation 69 the Department is guided by the following principles taken from the Louisiana Insurance Code.

1. "Insurance is a business affected with the public interest and it is the purpose of this code to regulate that business in all its phases." LSA-R.S. 22:2.
2. Insurers owe to their insureds a duty of good faith and fair dealing and have an affirmative duty to insureds and claimants alike to adjust claims fairly. LRS 22:1220.
3. Liability policies are issued for the benefit of injured persons and for the protection of insureds. LSA-R.S. 22:655.

Additional guidance is derived from traditional civilian principles found in the Civil Code. Of particular applicability is the principle that insurance contracts are contracts of adhesion. See Civil Code Article 2056 and the Comments thereunder. See also *15 Civil Law Treatise § 3*.

It is intended that this regulation be read in conjunction with Bulletin LIRC 98-04. If there are any inconsistencies between Regulation 69 and Bulletin LIRC 98-04, the provisions of the Regulation govern. This regulation does not restrict the authority of the LDOI, and other regulatory action, as warranted, may be taken in accordance with law.

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Section 8701. Authority

This regulation is adopted under the authority granted to the Commissioner of Insurance pursuant to LRS 22:2 to regulate the business of insurance in all of its phases.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:3.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:____.

Section 8703. Purpose

The purpose of this regulation is to set parameters on the use of Y2K exclusions and endorsements in order to protect the public interest and to assure the continued viability of the

insurance market in this state.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:3.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:____.

Section 8705. Scope and Applicability

This regulation applies to all property and casualty insurance companies, including admitted insurers, surplus lines insurers and brokers and reinsurers engaged in the business of insurance in this state. It also applies to all contracts of insurance delivered or issued for delivery in this state, and covering property or liability risks located in this state or to be performed in Louisiana regardless of where made or delivered. This regulation governs the use of all Y2K exclusions whether issued before, on or after its effective date.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:3., LRS 22:941, LRS 22:1262 and LRS 22:1262.1.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner LR 25:____.

Section 8707. Severability

If any section or provision of this regulation is held invalid, such invalidity shall not affect other sections or provisions which can be given effect without the invalid section or provision, and for this purpose the sections and provisions of this regulation are severable.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:3.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:____.

Section 8709. Definitions

A. For the purposes of this regulation the following terms shall have the meaning ascribed herein:

"Economic loss" means losses arising out of business transactions.

"File and use" means the filing of forms which may then be used by the insurer without receiving prior approval, subject to the LDOI's right of review and right to disallow continued use of the forms.

"LDOI" means the Louisiana Department of Insurance and/or the Commissioner of Insurance.

"LIRC" means the Louisiana Insurance Rating Commission.

"Y2K" means the year 2000 anno domini.

"Y2K exclusion" means all exclusions and endorsements

developed by the insurance industry, including but not limited to the ISO forms, to address coverage issues raised by the Y2K problem whether they are captioned "Y2K" or use terminology such as "date recognition", "computer related", "electronic data".

"Y2K problem" means the inability of computers and other electronic systems including embedded chips to accurately process, provide and/or receive date data from, into, and between the twentieth and twenty first centuries due to a programming design which causes the system to read "00" as 1900 not 2000. The term "Y2K problem" also includes problems resulting from the leap year calculation, date recognition problems attributed to the Global Positioning System arising on or after August 22, 1999 and the programming of 9/9/99 to read end of field or to delete data.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:3.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:___.

Section 8711. Forms Approval

Y2K exclusions are hereby exempted from the requirement that they be approved prior to use. Such exclusions may be submitted on a "file and use" basis if the filing complies with Section 7 of this regulation. Pending filings must be reviewed by the filer to determine compliance. If the original filing does not comply with this regulation the filing must be corrected and resubmitted. Authorization to issue Y2K exclusions expires on January 1, 2002. This exemption applies only to forms. Rate and rule filings must be made with the LIRC as required by law.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:3 and LRS 22:620E the applicable part of which provides that the Commissioner may exempt forms to which in his opinion Section 620 may not practically be applied.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:___.

Section 8713. Underwriting Standards

A. Except as provided herein, Y2K exclusions may not be used on a blanket basis. This standard applies to both property and liability coverage. Exclusions should not be used if the insured makes or has made a good faith effort to resolve its Y2K problems or if the insured has demonstrated compliance with Y2K criteria established by the insurer. If an exclusion is issued because the insured is unable to show that it has taken such steps, but later does demonstrate that it has met the criteria set by the insurer, the exclusion may be removed.

1. Personal Lines. Y2K exclusions are not approved for use in personal lines, including homeowner policies, farmowner policies and personal umbrella policies, except for business pursuits coverage. A Y2K exclusion may be used in connection with a personal lines policy's business coverage only if the company can document that there is a realistic risk of exposure which

warrants the use of a Y2K exclusion. The underwriting documentation must be maintained in the insured's file for a period of five (5) years from the date of issuance of the exclusion.

a. If a Y2K exclusion is attached to the business pursuits portion of a personal line policy it must provide coverage for ensuing perils otherwise covered by the policy and it must have an exception for on premises bodily injury.

2. Commercial Lines (including but not limited to Commercial Property, Boiler & Machinery, Commercial Auto, General Liability, Professional Liability, Directors & Officers and Business Owners).

a. Property Coverage. ISO's IL 09 35, FP 10 21 and BP 10 04 may be used on a mandatory basis as filed and approved. Y2K exclusions with substantially similar language and which provide coverage for ensuing perils (notwithstanding language in the policy which could be interpreted to the contrary such as "indirectly, concurrently caused, or regardless of other causes") may also be used in the same manner as ISO exclusions. But, because potential Y2K property exposures are definable and measurable hazards a filing which substantially deviates from the ISO exclusions referenced above must justify the conclusion that there is no impact on premium or specify the premium reduction to be given insureds in exchange for attaching the exclusion.

b. Y2K exclusions which do not contain language stating that ensuing perils are covered may not be used in Louisiana. If approval was granted to a Y2K exclusion in conflict with this provision, the approval is hereby withdrawn.

3. Liability Coverage. Use of Y2K exclusions with liability coverage is strongly discouraged and should be limited to those insureds which have failed to take adequate steps to correct their Y2K problem or which have excessive exposure to outside contamination. "Total" Y2K exclusions, such as ISO's CG 21 60, should be limited to high risk insureds. For other categories, Y2K exclusions which have an exception for bodily injury or which provide for the scheduling of risks and perils, such as ISO's CG 21 63 and CG 21 64, should be used.

a. And, except as provided below, Y2K exclusions may not be used for the following classes of risks: mercantile and restaurants, lodging and habitational, or institutional, such as churches and schools.

b. Y2K exclusions which provide for the scheduling of risks and perils, such as ISO's CG 21 63 and CG 21 64 may be used with a subclasses of the classes stated in the above paragraph if the insurer identifies and justifies the exposure to be excluded or limited in the specific subclass. An

insurer attaching a Y2K exclusion to an individual risk within such a subclass must maintain documentation in the underwriting file of each individual risk that identifies and justifies the exposure presented by that particular risk; and, maintain documentation that the insurer has provided loss control information to the insured. This documentation must be maintained in the insured's file for a period of five (5) years from the date of issuance of the exclusion.

4. Surplus Lines. Use of Y2K exclusions by surplus lines insurers should comply with this section. Failure to do so without justification may constitute grounds for removal from the list of approved unauthorized insurers.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:2, LRS 22:3. LRS 22:1211 et seq., LRS 22:941, LRS 22:1262 and LRS 22:1262.1.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:____.

Section 8715. Monitoring of Market Conduct

A. Each admitted insurer must file with the LIRC a list identifying the classes it has determined warrant the use of Y2K exclusion. The filing must contain the criteria used in determining that a particular class of business should be included on the list and identify the type of exclusion which will be used for each class. If an insurer issues a "total" Y2K exclusion (such as ISO's CG 21 60) to a risk within the filed classes it must be able to provide documentation upon request which identifies and justifies the exposure presented by that particular risk. If the list filed with the LIRC contains a subclass of any of the following classes the insurer must comply with the requirements imposed by Section 8713: mercantile and restaurants, lodging and habitational, or institutional, such as churches and schools.

B. Any insurer which denies coverage or issues a reservation of rights letter to an insured based in toto or in part upon a Y2K exclusion in the policy must notify the LDOI. The notice must be provided to the LDOI within fifteen (15) days of the denial of coverage or issuance of the reservation of rights letter. A copy of the denial of coverage letter or reservations of rights letter is sufficient notice.

C. The LDOI will closely monitor the use of Y2K exclusions to make certain that they are not used inappropriately in underwriting or claimshandling. Examples of inappropriate activity are: blanket use of Y2K exclusions; failure to individually underwrite except when authorized by this Regulation; denial of claims inconsistent with underwriting standards; canceling or nonrenewing coverage as a general business practice; widespread unavailability of "buy back" coverage; and, unsupported blanket denial of claims based upon "lack of fortuity", or the "known risk" and/or "expected or intended" exclusions.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:2, LRS 22:3. LRS 22:1211 et

seq., LRS 22:941, LRS 22:1215, LRS 22:1262, LRS 22:1262.1. LRS 22:1301 and LRS 22:1404.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:____.

Section 8717. Representations and Warranties

No representation or warranty may defeat coverage or be used to deny a claim unless the representation or warranty is (a) material (b) false) and (c) made with the intent to deceive. Questionnaires used to assess Y2K exposure are subject to this standard. Any denial of coverage on the grounds that an answer in a questionnaire is erroneous or inadequate, in the absence of fraud, will result in disciplinary action.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:3. LRS 22:619 and LRS 22:1262.1.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:____.

Section 8719. Notice

A. No policy may be issued or renewed with a Y2K exclusion unless the insured is provided with a copy of the Y2K Notice prepared by the LDOI.

B. Notice for renewals must be provided not less than sixty (60) days in advance to the insured and the agent of record; however, this requirement is not applicable to surplus lines insurers.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:2, LRS 22:3. and LRS 22:1262.1.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:____.

Section 8721. Exemptions

A. Lines of Coverage. If the commissioner finds that the application of this regulation unduly hinders the availability of coverage for a particular line of insurance he may, by written order, grant an exemption for so long as he deems proper.

B. Individual Insureds. An exemption may be granted upon written notification to the LDOI by an insurer regarding an individual policyholder which poses an extraordinary risk due to its failure to take any steps to remedy its Y2K problem. Documentation that demonstrates the necessity for the exemption must be maintained in the insureds file for a period of five (5) years from the date of issuance of the exclusion.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:2, LRS 22:3. and LRS 22:1262.1.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:____.

Section 8723. Penalties for Failure to Comply.

Noncompliance with this regulation by any insurer subject to its provisions may result in the imposition of such penalties as are authorized by law.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:2, LRS 22:3. LRS 22:1211 et seq., LRS 22:941, LRS 22:1115, LRS 22:1262.1. and LRS 22:1457.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25:____.

Section 8725. Effective Date

This regulation shall take effect upon publication in the Louisiana Register.

AUTHORITY NOTE: Promulgated in accordance with LRS 22:3.

HISTORICAL NOTE: Promulgated by the Department of Insurance, Office of the Commissioner, LR 25: ____.

James H. "Jim" Brown
Commissioner of Insurance

DEPARTMENT OF INSURANCE

SYNOPSIS

PROPOSED REGULATION 69
(LAC 37:XIII. Chapter 87)

Y2K EXCLUSIONS

The proposed regulation addresses the use of Y2K exclusions by all insurers doing business in Louisiana. The regulation addresses approval of form filings, underwriting and claims practices. It requires that certain information be filed with the LDOI and also requires notice to policyholders.

Because of the voluminous filings made by insurers, prior approval of forms is being waived and insurers will be able to file and use Y2K exclusions. However, the exclusions are only authorized for use until 1/1/2002.

The regulation establishes underwriting standards which must be adhered to by all insurers electing to use Y2K exclusions. Y2K exclusions may not be used in personal lines policies except in conjunction with business pursuits coverage. Insurers must provide a list to the LIRC of the classes of business which will have a Y2K excusion attached to the policy.

The regulation requires notice to the LDOI for claims denied based upon the Y2K exclusion. Also it requires that notice be given to insureds prior to attaching a Y2K exclusion to a policy. The notice will be developed by the LDOI. The regulation also provides a mechanism for obtaining an exemption for exceptional risks.

JAMES H. "JIM" BROWN

COMMISSIONER OF INSURANCE